

Sandvine Corporation

Consolidated Interim Financial Statements

February 28, 2011

(unaudited)

Sandvine Corporation

Consolidated Interim Balance Sheets

As at February 28, 2011

(in United States dollars, amounts in thousands) (unaudited)

	February 28 2011 \$	November 30 2010 \$ <i>Restated (note 2)</i>
Assets		
Current assets		
Cash and cash equivalents	16,785	87,949
Short term investments	73,237	-
Accounts receivable	17,997	25,485
Inventory	12,136	11,268
Other	3,979	3,201
	<u>124,134</u>	<u>127,903</u>
Non current assets		
Plant and equipment	12,020	12,341
Intangible assets (note 12)	6,382	5,125
Other assets	511	511
	<u>18,913</u>	<u>17,977</u>
	<u>143,047</u>	<u>145,880</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	9,529	12,005
Current portion of deferred revenue	11,453	10,257
	<u>20,982</u>	<u>22,262</u>
Non current liabilities		
Deferred revenue	620	703
	<u>620</u>	<u>703</u>
	<u>21,602</u>	<u>22,965</u>
Shareholders' equity		
Share capital (note 3)	120,169	119,570
Contributed surplus	10,462	10,007
Accumulated other comprehensive income	20,407	20,218
Deficit	(29,593)	(26,880)
	<u>121,445</u>	<u>122,915</u>
	<u>143,047</u>	<u>145,880</u>

On behalf of the Board:

Roger Maggs
Director

Dave Caputo
Director

See accompanying notes to the consolidated interim financial statements

Sandvine Corporation

Consolidated Interim Statements of Operations

For the three month period ended February 28, 2011

(in United States dollars, amounts in thousands, except share and per share data) (unaudited)

	February 28 2011 \$	February 28 2010 \$ <i>Restated (note 2)</i>
Revenue		
Product	13,492	17,797
Service	5,723	2,895
	<u>19,215</u>	<u>20,692</u>
Cost of sales		
Product	4,232	4,390
Service	1,407	878
	<u>5,639</u>	<u>5,268</u>
Gross margin	<u>13,576</u>	<u>15,424</u>
Expenses		
Sales and marketing	5,003	4,377
Research and development (note 6)	6,835	6,210
General and administrative	2,436	2,349
Stock based compensation (notes 3 and 4)	634	634
Amortization of intangible assets	356	477
Depreciation	1,029	926
	<u>16,293</u>	<u>14,973</u>
Income (loss) from operations	(2,717)	451
Interest and other income	42	47
Income (loss) before provision for income taxes	<u>(2,675)</u>	<u>498</u>
Provision for income taxes		
Current	38	34
	<u>38</u>	<u>34</u>
Net income (loss) for the period	<u>(2,713)</u>	<u>464</u>
Earnings (loss) per share (note 8)		
Basic	(0.020)	0.003
Diluted	(0.020)	0.003
Basic weighted average number of shares outstanding	137,076,308	135,829,754
Diluted weighted average number of shares outstanding	<u>137,076,308</u>	<u>139,591,777</u>

See accompanying notes to the consolidated interim financial statements

Sandvine Corporation

Consolidated Interim Statements of Changes in Shareholders' Equity and Comprehensive Income (Loss)

For the three month period ended February 28, 2011

(in United States dollars, amounts in thousands) (unaudited)

	Stated share capital \$	Contributed surplus \$	Retained earnings (deficit) \$	Accumulated other comprehensive income \$	Total \$
Balance, November 30, 2009 Restated (note 2)	118,714	7,680	(31,593)	16,257	111,058
Comprehensive income:					
Net income	-	-	464	-	464
Net unrealized losses on available for sale financial assets	-	-	-	(3)	(3)
Net unrealized loss on derivative financial instruments designated as cash flow hedges	-	-	-	(18)	(18)
Amount transferred to net income for derivatives designated as cash flow hedges	-	-	-	54	54
Foreign exchange adjustment on change in reporting currency (note 2)	-	-	-	388	388
Total comprehensive income					885
Stock based compensation (notes 3 and 4)	71	562	-	-	633
Employee share purchase plan (note 3)	(34)	7	-	-	(27)
Issued as compensation on business acquisition	47	-	-	-	47
Balance, February 28, 2010 Restated (note 2)	118,798	8,249	(31,129)	16,678	112,596
Balance, November 30, 2010 Restated (note 2)	119,570	10,007	(26,880)	20,218	122,915
Comprehensive loss:					
Net loss	-	-	(2,713)	-	(2,713)
Net unrealized gain on derivative financial instruments designated as cash flow hedges	-	-	-	180	180
Amount transferred to net income for derivatives designated as cash flow hedges	-	-	-	9	9
Total comprehensive loss					(2,524)
Stock based compensation (notes 3 and 4)	629	436	-	-	1,065
Employee share purchase plan (note 3)	(30)	19	-	-	(11)
Balance, February 28, 2011	120,169	10,462	(29,593)	20,407	121,445

As at February 28, 2011, the total of deficit and accumulated other comprehensive loss was \$(9,186) (February 28, 2010 - \$(14,451)).

See accompanying notes to the consolidated interim financial statements

Sandvine Corporation

Consolidated Interim Statements of Cash Flows

For the three month period ended February 28, 2011

(in United States dollars, amounts in thousands) (unaudited)

	February 28 2011 \$	February 28 2010 \$ <i>Restated (note 2)</i>
Cash provided by (used in)		
Operating activities		
Net income (loss) for the period	(2,713)	464
Items not affecting cash		
Amortization of intangible assets	356	477
Depreciation	1,082	993
Foreign exchange loss	14	120
Stock-based compensation (notes 3 and 4)	634	634
Other	(51)	-
	(678)	2,688
Changes in non-current balances	(83)	(69)
Changes in non-cash working capital balances	4,656	1,020
	3,895	3,639
Investing activities		
Purchase of plant, equipment and intangible software assets	(2,356)	(1,163)
Purchase of short term investments	(113,218)	(28,038)
Sale of short term investments	39,981	31,297
	(75,593)	2,096
Financing activities		
Proceeds from the issuance of share capital (note 3)	453	52
Effect of foreign exchange gain on cash and cash equivalents		
	81	13
Net increase (decrease) in cash during the period	(71,164)	5,800
Cash and cash equivalents – Beginning of period	87,949	2,218
Cash and cash equivalents – End of period	16,785	8,018
Cash and cash equivalents are represented by		
Balances with banks	16,466	3,718
Cash equivalents	319	4,300

See accompanying notes to the consolidated interim financial statements

Sandvine Corporation

Notes to the Consolidated Interim Financial Statements

February 28, 2011

(in United States dollars, amounts in thousands, except share and per share data) (unaudited)

1 Basis of presentation

The consolidated interim financial statements are prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) applicable to interim consolidated financial statements and prepared on a basis consistent with the audited financial statements for the year ended November 30, 2010, except as described in note 2. These consolidated interim financial statements do not conform in all respects to the requirements of generally accepted accounting principles for annual financial statements and should be read in conjunction with the November 30, 2010 audited consolidated financial statements.

The preparation of these consolidated interim financial statements requires management to make estimates and assumptions that affect the amounts reported in the consolidated interim financial statements and the accompanying notes. Actual results could differ from these estimates. Operating results for the three month period ended February 28, 2011 are not necessarily indicative of the results that may be expected for the full year ending November 30, 2011. In the opinion of management, all normal recurring adjustments considered necessary for fair presentation have been included in these financial statements.

Recently issued accounting standards

In January 2009, the CICA issued Section 1582, *Business Combinations*, replacing Section 1581, *Business Combinations*. This section establishes the standards for the accounting of business combinations, and states that all assets and liabilities of an acquired business will be recorded at fair value at the acquisition date. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. This new Section will be applicable to financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier adoption is permitted. The Company is evaluating the impact of adopting this new standard in connection with its conversion to International Financial Reporting Standards (“IFRS”).

In January 2009, the CICA issued Section 1601, *Consolidated Financial Statements*, which replaces the existing standards. This section establishes the standards for preparing consolidated financial statements and is effective for fiscal years beginning on or after January 1, 2011. Earlier adoption is permitted. The Company is evaluating the impact of adopting this new standard in connection with its conversion to IFRS.

2 Accounting policies

Change in functional and reporting currency

Effective December 1, 2010 (the “Conversion Date”), the Company adopted the U.S. dollar (“USD”) as its functional currency. This is the result of the continuing shift that the Company has experienced in the proportion of its revenues, expenses, assets and liabilities which are denominated in USD, and its expectation that this shift will continue in future periods. Prior to the Conversion Date, the Company’s operations were measured in Canadian dollars (“CAD”). On the Conversion Date the assets and liabilities were translated into USD using the exchange rate in effect on that date and equity transactions were translated at historical rates.

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In conjunction with this change in functional currency, the Company chose the USD as the Company's reporting currency. Historical financial statement information was restated into US dollars using the current rate method as required by the recommendations of Emerging Issues Committee ("EIC") recommendation EIC-130, *Translation method when the reporting currency differs from the measurement currency or there is a change in the reporting currency*. Under this method, assets and liabilities are translated at the closing rate in effect at the end of the periods reported. Revenues, expenses and cash flows are translated at the average rates in effect throughout the period, or the rates in effect at the date of the transaction for significant transactions. Any exchange differences resulting from the translation are included as part of Accumulated Other Comprehensive Income presented in Statement of Changes in Shareholders' Equity and Comprehensive Income (loss). As at November 30, 2010, the resulting net adjustment of \$20,218 has been credited to Accumulated Other Comprehensive Income (November 30, 2009 - \$16,345). The impact to Comprehensive Income for the three months ended February 28, 2010 and the twelve months ended November 30, 2010 was an increase of \$388 and \$3,873 respectively.

3 Share Capital

Share capital consists of the following:

	Common Shares		Common share warrant		Total
	#	\$	#	\$	
Balance, November 30, 2010	136,909,730	119,255	1	315	119,570
Issued under the employee stock option plan	639,656	453	-	-	453
Transfer from contributed surplus	-	176	-	-	176
Unvested shares held by trust	(10,449)	(30)	-	-	(30)
Balance, February 28, 2011	137,538,937	119,854	1	315	120,169

The Company has authorized an unlimited number of common shares.

The Company has one outstanding and authorized common share purchase warrant which entitles the holder to acquire 619,280 common shares for \$0.00001 CAD at any time prior to March 31, 2023. The issuance of this warrant was a non-cash transaction. The Company determined that the fair value of the warrant was \$315 at the time of issue.

During the three months ended February 28, 2011, the Company issued 639,656 common shares for cash proceeds of \$453 as a result of option holders exercising their options (February 28, 2010 – 81,358 and \$52).

The Company has a trust vehicle to facilitate its employee share purchase plan and hold shares of the Company allocated to individual employees. This trust is considered to be a variable interest entity and has been consolidated by the Company. Excluded from the outstanding common shares of the Company as of February 28, 2011 are 81,695 unvested common shares which are held by the trust (February 28, 2010 – 27,512).

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Notes to the Consolidated Interim Financial Statements

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4 Stock options

Stock option plan

The Company has adopted a stock option plan for employees and directors. Options granted prior to March 21, 2006 typically vest over a four year and six month term. Options granted subsequent to this date typically vest over a 5 year term. All options have a contractual life of 10 years and allow for the purchase of one common share per option. The exercise price of the options is the volume weighted average share price of the Company's common shares for the five days prior to the date of grant. As at February 28, 2011, there were 4,427,754 options available for future grants under the stock option plan. A summary of the stock option activity is presented below:

	Options	
	Number	Weighted average exercise price CAD\$
Options outstanding, November 30, 2010	10,397,237	1.67
Option activity for the period		
Forfeited	(120,748)	3.23
Exercised	(639,656)	0.71
Options outstanding, February 28, 2011	9,636,833	1.71

Stock based compensation

Stock based compensation (related to the Company's stock option plan) recognized for the three month period ended February 28, 2011 was \$612 with a corresponding credit to contributed surplus (February 28, 2010 - \$581). Previously recognized compensation expense of \$176 relating to options exercised during the three month period ended February 28, 2011 has been transferred from contributed surplus to share capital (February 28, 2010 - \$19).

For the three month period ended February 28, 2011, no stock options were granted.

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The following table summarizes information regarding stock options outstanding at February 28, 2011:

<u>Options Outstanding</u>				<u>Options Exercisable</u>	
Range of exercise price CAD\$	Number outstanding	Weighted average contractual life (years)	Weighted average exercise price CAD\$	Number outstanding	Weighted average exercise price CAD\$
0.40 - 0.82	2,412,217	4.69	0.67	1,876,889	0.64
1.05 - 2.53	6,129,286	7.81	1.53	1,844,048	1.83
4.11 - 5.50	796,830	6.58	4.39	545,478	4.41
6.59 - 6.95	298,500	6.45	6.71	209,101	6.70
0.40 - 6.95	9,636,833	6.89	1.71	4,475,516	1.87

5 Lease commitments

Future minimum operating lease payments for premises over the next five years and thereafter are as follows:

	\$
2011	747
2012	1,286
2013	1,182
2014	1,117
2015	1,117
Thereafter	<u>5,365</u>
	<u>10,814</u>

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6 Government assistance

Government assistance and repayments, together with investment tax credits, have been applied to research and development expense as follows:

	For the three months ended	
	February 28 2011	February 28 2010
	\$	\$
Research and development	7,007	6,219
Government repayments	497	585
Investment tax credits / government assistance	(669)	(594)
	6,835	6,210

The Company has an agreement with Technology Partnership Canada (“TPC”) who provided partial funding towards one of the Company’s research and development projects. The Company received \$9,500 CAD (\$9,780 USD) over a twenty-two month period which ended during fiscal 2005. The agreement requires the contribution to be repaid in the form of royalties to a maximum of \$16,000 CAD (\$16,470 USD). Royalties are charged at 2.5% of the Company’s gross revenues. The obligation to pay royalties expires on November 30, 2013. During the three month period ended February 28, 2011, the Company recognized \$473 (February 28, 2010 - \$520) as royalty expense which has been recorded as an increase to research and development expenses. Cumulatively, the Company has accrued or paid total royalties of \$7,170 CAD (\$7,387 USD) under the agreement.

A subsidiary of the Company participates in programs sponsored by a foreign government body for the support of research and development activities. The subsidiary is obligated to pay royalties, amounting to 3% - 3.5% on sales and other related revenues generated from the subsidiary’s products up to the amount granted plus interest. The subsidiary’s obligation to pay these royalties is contingent on actual sales of its products, and in the absence of such sales, no payment is required. During the period ended February 28, 2011, the Company recognized \$24 (2010 - \$65) as royalty expense which has been recorded as an increase to research and development expenses. As of February 28, 2011, the subsidiary has received cumulative grants of \$2,326. Cumulatively, the Company has accrued or paid total royalties of \$564 under the agreement.

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Non repayable government assistance recorded during the period of \$156 (2010 - nil) relates to funding received through a Canadian government program in respect of certain research and development activities undertaken by the Company.

The Company has entered into an agreement with the Province of Ontario relating to the Next Generation of Jobs Fund, which will provide funding relating to one of the Company's projects. Under the agreement, the Company will be eligible to receive funding equal to 11% of eligible project expenditures from February 24, 2009 to February 24, 2014 to a maximum of \$18,700 CAD (\$19,250 USD) (the "Initial Grant"). Payments made in respect of the Initial Grant can become conditionally repayable if certain cumulative job targets are not met. In addition, at the end of the agreement, the Company may be entitled to receive up to an additional 4% of eligible project expenditures (to a maximum of \$6,800 CAD (\$7,000 USD)) if certain Ontario-based job targets have been met. During the period ended February 28, 2011, the Company recorded \$902 of funding eligible from the program. As at February 28, 2011, cumulative funding received under this program is \$5,424 CAD (\$5,488 USD). The amount of funding received in respect of eligible expenses is as follows:

	For the three months ended	
	February 28 2011	February 28 2010
	\$	\$
Sales and marketing	44	-
Research and development	513	-
General and administrative	251	-
	<hr/>	<hr/>
	808	-
	<hr/>	<hr/>
Purchase of plant, equipment and intangible software assets	94	-
	<hr/>	<hr/>
	902	-
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(in United States dollars, amounts in thousands, except share and per share data) (unaudited)

7 Segment disclosures

The Company has one reportable segment. The Company's operations are substantially all related to the research, design, manufacturing and sales of network management equipment and solutions for broadband service providers. Selected financial information is as follows:

	For the three months ended	
	February 28 2011	February 28 2010
	\$	\$
Sales		
Canada	285	517
United States	5,182	10,222
Caribbean and Latin America	850	1,759
Europe, Middle East and Africa	4,831	4,718
Asia Pacific	8,067	3,476
	<hr/>	<hr/>
	19,215	20,692
	<hr/>	<hr/>
	%	%
Sales		
Canada	1.5	2.5
United States	27.0	49.4
Caribbean and Latin America	4.4	8.5
Europe, Middle East and Africa	25.1	22.8
Asia Pacific	42.0	16.8
	<hr/>	<hr/>
	100.0	100.0
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In situations where a sale is made through a reseller, revenue associated with that sale is attributed to the geographic location of the end customer. Revenue from individually significant countries contained within these geographic regions included Japan, which represented 39.4% of revenue for the three months ended February 28, 2011 (2010 – 7.8%).

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Major customers are customers which represent more than 10% of total revenues for a given period. For the three month period ended February 28, 2011 one major customer represented 38.8% of total revenue (February 28, 2010 – three customers, 54.3%).

	February 28 2011	November 30 2010
	\$	\$
Plant and equipment and intangibles		
Canada	16,805	15,680
United States	76	90
Europe, Middle East and Africa	1,521	1,696
	<hr/>	<hr/>
	18,402	17,466
	<hr/>	<hr/>
Total assets		
Canada	140,072	143,317
United States	274	261
Europe, Middle East and Africa	2,701	2,302
	<hr/>	<hr/>
	143,047	145,880
	<hr/>	<hr/>

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Notes to the Consolidated Interim Financial Statements

February 28, 2011

(in United States dollars, amounts in thousands, except share and per share data) (unaudited)

8 Earnings (loss) per share

	February 28 2011 \$	February 28 2010 \$
Numerator for basic and diluted earnings (loss) per share available to common shareholders	(2,713)	464
Denominator for earnings (loss) per share, weighted average number of shares outstanding		
Basic	137,076,308	135,829,754
Effect of warrant outstanding	-	619,280
Effect of stock options issued	-	3,117,214
Effect of contingently returnable shares	-	25,529
Diluted	137,076,308	139,591,777
Earnings (loss) per share:		
Basic	(0.020)	0.003
Diluted	(0.020)	0.003

In periods where the Company incurred losses attributable to common shares, options granted under the Company's stock option plan, contingently returnable shares and the common share purchase warrant have been excluded in the diluted loss per share calculation as their inclusion would have been anti-dilutive.

9 Supplemental cash flow information

For the three month period ended February 28, 2011 the Company paid \$16 for income tax in cash (February 28, 2010 - \$9). The Company did not pay any interest in cash during the period ended February 28, 2011 (February 28, 2010 - \$nil).

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Notes to the Consolidated Interim Financial Statements

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(in United States dollars, amounts in thousands, except share and per share data) (unaudited)

10 Financial Instruments

Due to a change in the Company's functional currency, the Company's financial exposure to foreign currency risk has changed from that disclosed at November 30, 2010.

The Company's financial results are reported in United States dollars. The Company transacts business in multiple currencies, the most significant of which are the USD, the CAD, the Euro, the Great British Pound and the New Israeli Shekel. As a result, the Company has foreign currency exposure with respect to items denominated in foreign currencies. The Company's objective with regard to its foreign currency risk is to minimize the impact of foreign exchange movements on the Company's consolidated financial statements.

The Company generates the majority of its revenues in the USD. If a significant sales transaction is generated in a currency other than the USD, and this transaction exceeds the natural hedge provided by expenditures in those currencies the Company may enter into forward foreign exchange contracts. The timing and amount of these forward foreign exchange contracts are estimated based on customer contracts on hand and expected future cash outflows. The Company does not account for these forward contracts using hedge accounting. As a result these instruments are measured at fair value with changes in fair value recognized in earnings.

The Company incurs costs, primarily payroll and related expenditures, in the CAD and New Israeli Shekels which exceed the natural hedge provided by inflows in these currencies. The Company utilizes a hedging program to manage these net foreign currencies using forward foreign exchange contracts. The timing and amount of these forward foreign exchange contracts is based on expected future cash outflows. The Company applies hedge accounting to these forward contracts. As a result these instruments are measured at fair value with the effective portion of the change in fair value initially recorded in other comprehensive income and reclassified to the consolidated statements of operations in the same period that the hedged anticipated transaction affects earnings.

The following table summarizes the Company's commitments to buy foreign currencies under foreign exchange contracts, all of which have a maturity date of less than one year, as at February 28, 2011:

Designation	Currency Sold	Currency Bought	Notional Amount Bought	Weighted Average Rate
Held for trading; cash flow hedges	USD	ILS	9,930	0.2764
Held for trading; cash flow hedges	USD	CAD	15,650	1.0121

Management estimates that a gain of \$189 would be realized if these foreign exchange contracts were terminated on February 28, 2011 (November 30, 2010 – loss of \$20).

The Company has assessed the net foreign currency exposure of its foreign denominated financial instruments relative to the USD. A fluctuation of +/- 5%, provided as an indicative range in a volatile currency environment, would, with all other variables held constant, have an effect on accumulated other comprehensive income for the period ended February 28, 2011 of +/- \$984 and on net income for the period ended February 28, 2011 of approximately +/- \$152.

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11 Credit facility

The Company has a demand credit facility with a major Canadian chartered bank. During the quarter the credit facility was amended to a USD facility. Under the terms of the facility, the Company has available to it a \$1,000 operating line to provide letters of credit and a \$3,750 contingency line to permit the Company to enter into foreign currency forward contracts. Borrowings made from the facility attract interest at the bank's prime rate of interest plus 0.5%. Short term investments with a carrying value and fair value of \$4,750 are pledged as security for the credit facility. The assets pledged as security can be called by the lender upon default of the facility or insolvency of the Company. The facility and the related security will remain in effect until the facility, which has no term, is terminated. In addition, the Company has available to it a \$10,000 spot foreign exchange facility.

As of February 28, 2011 the Company had issued three letters of credit under its operating line. The individual letters of credit were; US\$292 expiring July 15, 2011, US\$16 expiring July 24, 2011 and US\$79 expiring August 31, 2011. As of February 28, 2011, the Company had utilized \$722 of its contingency line relating to foreign currency forward contracts.

12 Acquisition of intangible software asset

During the three months ended February 28, 2011, the Company capitalized \$1,520 relating to the ongoing implementation of a new Enterprise Resource Planning ("ERP") system.